

**MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM**

Washington Monthly Report

Mandatory Social Security for New State and Local Workers

We are continuing to work closely with STRS staff to carry out a comprehensive legislative strategy to stave off mandatory coverage of new State and local workers as a financing option in the Social Security reform debate that is taking place on Capitol Hill. These ongoing efforts include extensive grassroots activities in California, ongoing contacts in Washington with key Members of the California Congressional delegation, coordination with interested California government groups with a Washington presence, and coordination with national groups of State and local government employers and employees.

STRS staff is continuing to generate a broad-scale grassroots effort in California, including superintendents, school boards, school business officers, community college leaders, and active and retired teacher groups from across the State. Based on our discussions with the California Congressional offices in Washington, the message is getting through and is being heard.

In addition, STRS staff helped to coordinate the attached joint letter from key California State and local employer and employee groups vigorously opposing mandatory Social Security for new State and local workers. We delivered this letter to the offices of the President and the Vice President, the Chairmen and Ranking Minority Members of the House Ways and Means and Senate Finance Committees and the House Ways and Means Social Security Subcommittee, all 52 members of the California delegation in the House of Representatives, and the two California Senators. In addition, we understand that STRS staff is pursuing a joint resolution in the California legislature opposing mandatory Social Security.

We have continued to coordinate with an informal working group of California State and local government organizations which have a Washington presence. The group is hosted by the California League of Cities and the California State Association of Counties.

In addition, we also are continuing to actively work with an informal group of Washington-based national organizations of State and local employers and employees to mount a comprehensive, coordinated Congressional lobbying effort. The National Education Association seems to have finally swung into action and is now making Congressional contacts on the issue. It is less clear as to the level of activity of the American Federation of Teachers. These legislative efforts by the working group of Washington-based national organizations are critical because the Coalition to Preserve Retirement Security, the coalition formed to oppose mandatory Social Security, continues to devote most of its attention to internal organizational matters rather than to marshaling grassroots contacts by its members.

Senator Feinstein and Senator George Voinovich (R-Ohio) (the former Governor of Ohio) are seeking signatures from their Senate colleagues on a letter to President Clinton urging him to exclude mandatory coverage from any Social Security reform package he proposes. (See copy attached). STRS staff had discussions with Senator Feinstein's staff, and helped win her over to a position of active leadership from an initial position of tentative support.

On a related front, we have filed the enclosed statement by Emma Zink, as Chair of the Board, with the House Ways and Means Social Security Subcommittee and the Senate Budget Committee. The statement responds to assertions by Fed Chairman Alan Greenspan and others that State and local plans have lagged in investment performance in comparison to private plans because of "political interference" in investment policy. As reported last month, opponents of the President's plan to directly invest a portion of the Social Security trust fund in the equities market have taken to flogging the performance of State and local plans as a means of arguing that direct equity investment of Social Security trust fund monies by the Federal government would be ripe for "political interference".

On March 3, the House Ways and Means Social Security Subcommittee held a hearing attacking the President's proposal on direct investment in the stock market. The hearing went rather as expected, with a series of witnesses attacking the investment practices of State and local plans as an ominous indication of things to come under a Federal direct investment plan. However, Rep. Bob Matsui (D-Sacramento), the ranking Democrat on the Social Security Subcommittee, defended the investment performance of State and local plans -- particularly the public plans in California. For their part, the Republican Members of the Subcommittee did not "pile on" during the questioning period, preferring to leave to the witnesses the task of criticizing.

At the hearing, a witness formerly associated with the Connecticut plan, Maureen Baronian, testified that there is no way to insulate a governmental plan from "the possibility of political interference." A witness from the Cato

Institute, Michael Tanner -- who reportedly has cited the performance of State and local plans approvingly in the past -- railed on and on about State and local plans' corporate governance "interference", social investment policy, restrictions on investment, tobacco and South Africa divestiture, and the lot. Carolyn Weaver of the American Enterprise Institute asserted that 23 percent of all State and local plan investments are "politicized". There was not a lot of hard science at work here.

The thrust of Chairperson Zink's statement is that, while CalSTRS does not intend to inject itself into the larger debate over Social Security privatization, as one of the largest State retirement systems in the country STRS felt compelled to respond to any suggestion that State and local plans and their governing bodies somehow have failed to fulfill their fiduciary responsibilities. The statement points out that the Teachers' Retirement Board has fully discharged its fiduciary responsibilities to manage the retirement plan for the exclusive benefit of its 600,000 active and retired teacher members, operating the plan on an essentially fully-funded basis to pay out almost \$3 billion a year in benefits that have been pre-funded from employer and employee contributions and investment returns.

Chairperson Zink's statement on the CalSTRS experience is complementary to the approach taken by the national groups, including the National Conference of State Legislators, the National Association of State Retirement Administrators, and the National Council on Teacher Retirement which filed a statement with the various Congressional committees showing that investment performance by public plans was quite comparable with private plans over a series of time horizons.

Thus, on the issue of State and local plan investment performance, we have filed Emma Zink's statement on behalf of the Board with the appropriate Congressional committees, and the national groups have delivered the defense of State and local plan investment performance and practices in the strongest possible terms. Having defended ourselves on this point, it is now time to move on, back to the most crucial issue of mandatory coverage.

In the weeks ahead, we will be continuing to coordinate with STRS staff, the California government groups based in Washington, and the Washington-based national organizations to actively pursue ongoing contacts with key Members and staff on Capitol Hill.

House Ways and Means Social Security Subcommittee Chairman Clay Shaw (R-Fla.) recently indicated that the Social Security reform plan he is developing in conjunction with House Ways and Means Chairman Bill Archer (R-Tex.) will be unveiled by late April. Apparently, the plan will be released in concept at that time, rather than in legislative language introduced in the House. The plan

reportedly will include a private accounts feature, but details are being very closely held for now with the plan still under development. The specifics of the financing for the plan remain a significant outstanding issue.

Sources have indicated informally that the Shaw-Archer plan will not contain a provision mandating Social Security coverage for new State and local workers. However, it remains way early in the process, and we need to continue to vigorously press our opposition to mandatory coverage. Ways and Means Chairman Archer has been reaching out in an effort to gain bipartisan support to Sens. Daniel Patrick Moynihan (D-N.Y.) and Bob Kerrey (D-Neb.), two Senators influential on Social Security who have embraced mandatory State and local coverage in the past. In addition, the need to finance private accounts always risks the possibility that mandatory coverage will come onto the table as a near-term financing option. Our sense at this point is that, across the full membership of the House Ways and Means and Senate Finance Committees, there are a significant number of Members who would “turn their heads” and be willing to let mandatory coverage happen, if that were necessary as part of a package to reach a deal -- particularly a bipartisan deal -- on Social Security reform.

The prospects for Social Security reform this year remain very clouded. Coming out of the impeachment proceedings, both parties in Congress have resumed their partisan jousting on policy issues, including Social Security reform. The President thus far has declined to put any specifics to his call for dedicating 62 percent of the Federal budget surplus to protecting Social Security solvency. Even some of the Administration’s strongest supporters in Congress, such as Rep. Matsui, are becoming exasperated with the Administration’s failure to provide a detailed plan for Congressional Democrats to work from and pursue. For their part, the House Republicans have chosen to pursue a GOP plan at this juncture, rather than to attempt to negotiate a bipartisan plan.

Elk Hills Compensation

We are continuing the legislative efforts to seek the Congressional appropriation that is necessary to obtain the second \$36 million installment payment of compensation due to STRS under the \$320 million settlement of the State’s Elk Hills claim that we helped negotiate with the Federal government. We drafted, and following review by STRS staff, filed with the House and Senate Interior Appropriations Subcommittees the attached written statement urging enactment of the necessary appropriation.

We understand that STRS is set to receive on March 29 the actual payment of the first \$36 million installment of compensation resulting from the hard-fought appropriations legislation last Fall.

The appropriations battle is likely to be even tougher this year now that the Republican Leadership in Congress has chosen to adhere to the cap on discretionary spending under current law. The overall cap on discretionary spending ratchets down in FY 2000 to a level that is some \$36 billion less than last year's spending level. It remains to be seen whether the revised Congressional Budget Office budget forecast due out in August will project a greater budget surplus for FY 2000 and thereby provide Congressional leaders some additional flexibility with respect to the budget caps.

Portman-Cardin Pension Liberalization Legislation

Reps. Rob Portman (R-Ohio) and Ben Cardin (D-Md.) introduced on March 11 the "Comprehensive Retirement Security and Pension Reform Act" (H.R. 1102). The measure is generally similar to pension liberalization legislation Reps. Portman and Cardin introduced last year. (Copies of the legislation and accompanying explanation have been provided to STRS staff for their review.)

The legislation proposes a broad-ranging series of liberalizing changes to the current law limits on benefits and contributions for tax-qualified retirement plans such as STRS and enhancing portability among defined benefit and defined contribution plans, section 403(b) plans, and section 457 deferred compensation plans, as well as a series of other changes intended to remove impediments to retirement savings.

The bill would increase the section 415 dollar limit on benefits to \$180,000 and for governmental plans would place a floor of \$130,000 on the actuarial reduction of the dollar limit for early retirement that begins on or after age 55. (For defined contribution plans, the maximum annual contribution limit would be raised from \$30,000 to \$45,000, and the annual limit on contributions of 25 percent of the participant's compensation would be repealed.) Annual contribution limits to section 403(b) plans and section 457 plans would be raised to \$15,000, and the current law rule lowering the section 457 contribution limit for each dollar contributed to a section 403(b) plan would be repealed. The annual contribution limits on section 403(b) plans (and other defined contribution plans) and section 457 plans would be increased by \$5,000 for participants aged 50 and older so that they can "catch up" for earlier years when they were out of the workforce raising a family or otherwise contributing less than they now wished they had.

The measure includes a series of provisions intended to enhance portability in the State and local government sector. State and local employees would be permitted to purchase service credit under a governmental defined benefit plan with amounts transferred by means of a direct trustee-to-trustee transfer from

a section 403(b) plan or section 457 plan. In addition, to permit the consolidation of a person's retirement assets in a single retirement plan, rollovers would be broadly permitted among all types of tax-qualified plans, including defined benefit plans, defined contribution plans, section 403(b) plans, and section 401(k) plans, and pre-tax contributions that had been made to an IRA. A refund of after-tax contributions could be rolled over to an IRA. Distributions from section 457 plans also could be rolled over into an IRA.

A hearing is being held on the Portman-Cardin bill by the House Ways and Means Oversight Subcommittee on March 23. The measure's proposed increase in the section 415 limits on contributions and benefits is likely to have a substantial revenue cost and could face an uphill battle as a result. The provisions on State and local governmental plan are likely to be of only modest cost and face a reasonable prospect of being included in any broad tax legislation considered by the House Ways and Means Committee later this year.

Companion legislation to the Portman-Cardin bill is expected to be introduced shortly in the Senate by Sens. Charles Grassley (R-Iowa) and Bob Graham (D-Fla.).

Senate Finance Committee Chairman Bill Roth (R-Del.) and Sen. Max Baucus (D-Mont.) have introduced a much narrower pension bill (S. 649) that liberalizes the IRA annual contribution limit, raises the section 457 annual limit to \$15,000, and increases the section 403(b) annual contribution limit to \$15,000, but does not contain the public sector portability changes in the Portman-Cardin bill.

John S. Stanton

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